83-468

No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

BURLINGTON NORTHERN RAILROAD COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA AND
INTERSTATE COMMERCE COMMISSION,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

I. Whether the Interstate Commerce Commission, in an unprecedented action without statutory or other legal authority, could compel a rail carrier to sell a one-half interest in an operating rail line to another carrier on terms and at a price prescribed by the Commission.

II. Whether, even assuming the Commission had the power to order a forced sale in these circumstances, its asserted reasons for the forced sale were ex post facto rationalizations not based on substantial evidence or an adequate record, and the price and terms it imposed were arbitrary and capricious in that, among other things, the Commission failed to compensate the selling carrier adequately for the risks it bore in constructing the rail line without assistance from the purchasing carrier.

LIST OF CORPORATE SUBSIDIARIES AND AFFILIATES

Petitioner's parent company is Burlington Northern Inc. The partially-owned subsidiaries and affiliates of the petitioner are:

BN Financial Services Inc.
BN Timberlands Inc.
Burlington Northern Airmotive Inc.
Burlington Northern International Services Inc.
The Belt Railway Company of Chicago
Camas Prairie Railroad Company
Chicago Union Station Company
Davenport, Rock Island and North Western Railway Company
The Denver Union Terminal Railway Company
Galveston Terminal Railway Company
Houston Belt & Terminal Railway Company
Iowa Transfer Railway Company
Kansas City Terminal Railway Company
Keokuk Union Depot Company
The Lake Superior Terminal and Transfer Railway Company
Longview Switching Company
The Minnesota Transfer Railway Company
Paducah & Illinois Railroad Company
Portland Terminal Railroad Company
The Pueblo Union Depot and Railroad Company
The Saint Paul Union Depot Company
Terminal Railroad Association of St. Louis
Trailer Train Company
The Wichita Union Terminal Railway Company
Winona Bridge Railway Company
Glacier Park Company
Glacier Park Liquidating Company
Meridian Land & Mineral Company

Milestone Petroleum Inc.
Butte Pipe Line Company
Portal Pipe Line Company
New Mexico and Arizona Land Company
Plum Creek Inc.
P-H Holdings Corporation
The El Paso Company

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The petitioner Burlington Northern Railroad Company respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered in this proceeding on March 29, 1983.

OPINIONS BELOW

The judgment of the Court of Appeals, which is noted at 704 F.2d 1293 (D.C. Cir. 1983), appears in the Appendix at 1a to 2a. The memorandum opinion issued by the panel in connection with the denial of rehearing appears in the Appendix at 5a to 7a. The November 3, 1982 decision of the Interstate Commerce Commission appears in the Appendix at 8a to 10a. The October 22, 1982 decision of the Commission appears in the Appendix at 11a to 40a.

JURISDICTIONAL STATEMENT

The judgment of the Court of Appeals for the District of Columbia Circuit was entered on March 29, 1983. A timely petition for rehearing and suggestion for rehearing *en banc* was denied on June 21, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

Sections 10901, 11701, 11343 and 11344 of the Revised Interstate Commerce Act, 49 U.S.C. §§ 10901, 11701, 11343 and 11344 (Supp. V 1981), are set forth in the Appendix at 80a to 89a. Section 10(e) of the Administrative Procedure Act, 5 U.S.C. § 706 (1976), is set forth in the Appenidx at 89a to 90a.

STATEMENT OF THE CASE

This case concerns a 103-mile segment of rail line in the southern Powder River Basin area of Wyoming which was built by petitioner Burlington Northern Railroad Company [1] between 1976 and 1979 to move large volumes of coal. BN originally applied to the ICC in 1972 to construct this line as an independent project. In 1973, Chicago and North Western Transportation Company [2] applied to build a 76-mile line into the Basin on a parallel route. The Commission, concerned with the environmental problems of building parallel rail lines through the area, persuaded the parties to consolidate their applications into a single proposal for a joint line.

On January 9, 1976, the Commission granted a certificate approving the Powder River Basin line, which was

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[1] Burlington Northern Railroad Company was formerly known as Burlington Northern Inc., a name now used for BN's parent holding company.

[2] "North Western" will be used to refer to the Chicago and North Western Transportation Company and its wholly-owned subsidiary, Western Railroad Properties, Incorporated.

to be the longest new rail line in the United States since 1931. *Burlington Northern, Inc.*, 348 I.C.C. 388 (1976), *petition for review dismissed sub nom. Sierra Club v. United States*, No. 76-1557 (D.C. Cir. Dec. 21, 1978) [hereinafter cited as *1976 Decision*].[3] In its decision, the Commission carefully noted that the issue before it was whether "the present or future public convenience and necessity requires or will require the construction and operation of the proposed line." 348 I.C.C. at 400, App. at 71a. The Commission's sole reason for authorizing "joint" authority was "to avoid the construction of essentially parallel lines by the applicants." *Id.* at 399, App. at 71a. As the Commission observed, "Two railroads serving the same territory over separate lines would result in wasteful and improvident expenditures for construction which are not necessary to insure adequate service, especially in view of the environmental and financial considerations involved." *Id.*

At no point in its *1976 Decision* did the Commission advert to competition as a rationale for its decision, nor did it suggest that the presence of both BN and North Western was essential to effectuate the authority. To the contrary, the Commission reserved the authority to disapprove North Western's future financing plans, thus indicating the distinct possibility that North Western might never be able to exercise its share of the joint authority. *Id.* at 402, App. at 74a-75a; *see also id.* at 406, App. at 79a (Commissioner O'Neal, dissenting in part) ("North Western has not provided evidence . . . sufficient . . . to demonstrate its ability to finance the proposed construction and operation without detracting from its ability to perform its common carrier obligation.").

The Commission's *1976 Decision*, by its terms, was thus entirely permissive; that is, it authorized both parties

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[3] For the convenience of the Court, the text of the *1976 Decision* is reprinted in the Appendix at 56a to 79a.

together, or either party singly, to go forward with construction and operation of the line. If an unwilling partner chose not to exercise its share of the authority, there was no condition, either express or implied, preventing the willing partner from going forward without further Commission approval. Similarly, the Commission could in no way compel an unwilling partner to go forward.

At the time of the certification decision, BN and North Western had already negotiated a draft agreement governing construction and operation of the line. *See* App. at 46a. Under this agreement, the parties were to share equally in the construction costs and each was to own an undivided one-half interest in the facilities. BN began construction, but North Western failed to pay its share of the construction costs. On two occasions, BN voluntarily extended the payment deadline, but North Western still failed to pay. In late 1979, BN completed construction and started single-carrier operations on the new line. App. at 47a.

Despite North Western's repeated contractual defaults, it continued to insist upon a right not only to participate in the project, but to do so on the original terms.[4] On February 19, 1982, North Western asked the ICC to prescribe the terms of the 1975 agreement as a basis for North Western to re-enter the Powder River Basin project. *See* App. at 48a-49a. BN responded by pointing out that prescription was both unfair and unnecessary, since BN was already negotiating in good faith with North Western for sale of a one-half interest in the line. None-

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[4] To attract financing, North Western redesigned its proposal to transport coal from the Powder River Basin, bringing in the Union Pacific Railroad as a joint venturer and ultimately obtaining ICC approval for a new line connecting North Western's tracks with those of the Union Pacific. *Chicago & N.W. Transp. Co.*, 363 I.C.C. 906 (1981) [hereinafter cited as *1981 Decision*], *aff'd sub nom.* Mobil Oil Corp. v. ICC, 685 F.2d 624 (D.C. Cir. 1982).

theless, on May 21, 1982, the Commission issued a show-cause order directing BN to state a "buy-in" price and to explain in detail the methodology used to compute the price. App. at 53a. In response, BN reiterated its long-standing position that the Commission had no authority to compel the sale of the rail line on terms and conditions of the Commission's choosing. However, to demonstrate its good faith, BN submitted a detailed proposal for an appropriate operating agreement and for sale of a one-half interest in the line for $95.5 million, a price calculated by BN's independent financial advisers, Morgan, Stanley & Co., Inc.

If at this point the Commission had believed that BN's asking terms and operating agreement were so unreasonable that they effectively excluded North Western from the project, the Commission could have instituted a proceeding to determine whether BN was operating in violation of the 1976 certificate. *See* 49 U.S.C. § 11701(a) (Supp. V 1981). The Commission had previously announced that this was exactly the tack it intended to take should circumstances so require. *See 1981 Decision*, 363 I.C.C. at 920 n.13. Exercise of this express statutory power would have entitled BN to a formal hearing. 49 U.S.C. § 11701(a) (Supp. V 1981). More important, the focus of the hearing would have been whether BN was negotiating in good faith. There would have been no presumption that BN was obligated to reach agreement with North Western, only an assurance that BN could not exclude North Western by insisting upon terms of sale that were unrealistic or unreasonable.

Instead of pursuing this well-marked course, the Commission proceeded to create a new form of administrative proceeding, without precedent or statutory sanction. First, in apparent recognition of its lack of prescription authority, the ICC asked each party to submit to binding arbitration by the Commission. App. at 42a. BN declined, but did submit a "final best offer" that paralleled

its earlier offer of $95.5 million. *See* App. at 14a. North Western's "final best offer" for purposes of binding arbitration was $83 million; otherwise it offered $60 million. *See* App. at 14a.

Based solely on these conflicting offers and the written evidence underlying them, on October 22, 1982 the ICC issued the order under review. App. at 30a [hereinafter cited as *October 1982 Decision*].[5] In that order, the Commission required BN to sell a one-half interest in a defined segment of the Powder River Basin line to North Western for $76.2 million. *October 1982 Decision* at 6, App. at 19a. The Commission also prescribed the terms of an operating agreement between the parties, requiring among other things that BN bear all of the labor protection costs caused by North Western's belated entry. *October 1982 Decision* at 11, App. at 27a-28a. On BN's petition for review, the United States Court of Appeals for the District of Columbia Circuit issued a one-page judgment, without opinion, affirming the Commission's decision. App. at 1a. A timely petition for rehearing and suggestion for rehearing en banc was denied on June 21, 1983, with a three-page memorandum opinion from the panel explaining its original judgment. App. at 5a.

The panel opinion on rehearing reflected a fundamental misreading of the *1976 Decision* and its consequences. The opinion correctly noted that BN and North Western were granted joint authorization and that North Western "did not . . . meet its financial obligations, repeatedly failing to tender its share of the construction costs." App. at 5a. It then implied, however, that BN was obligated to "notify[] the Commission of the changed conditions and request[] that it be made sole owner and operator of the line" before it could implement the authority it had been

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[5] Subsequently, on November 3, 1982, the Commission issued a further order clarifying its *October 1982 Decision*. *See* App. at 8a to 10a.

granted. App. at 5a. The panel cited no authority and nothing in the *1976 Decision* for this proposition.

Based upon its misreading of the *1976 Decision*, the panel advanced three bases for the Commission's authority to prescribe the price and terms for the sale to North Western. First, the panel said, the Commission has the power under 49 U.S.C. § 10901 to require applicants to comply with "conditions the Commission finds necessary," and this power permits the Commission to enforce the alleged condition in the 1976 certificate that BN's authority could only be exercised jointly. App. at 6a. Second, the court said, the *1976 Decision* "necessarily required" the carriers to agree to a joint ownership and operating agreement which the Commission is empowered under 49 U.S.C. §§ 11343 and 11344 to approve and upon which it may impose conditions. App. at 6a. Third, the panel said, the Commission has "implied power to prescribe particular terms and conditions necessary to the public interest in the course of exercising its explicit statutory authority." App. at 6a. On these grounds, and based upon the "unusual circumstances of this case," the court upheld the Commission's unprecedented action of prescribing the price and contractual terms of the sale. The court did not address the issue of the Commission's arbitrary exercise of its asserted authority, except to say in conclusory terms that the price prescribed was "fair." App. at 6a.

REASONS FOR GRANTING THE WRIT

I. The Decision Below Effectively Grants the ICC Unprecedented Implied Authority Over Private Rail Carrier Transactions

The court below committed a fundamental legal error by interpreting the *1976 Decision* of the ICC as though it had included a condition that BN could exercise the granted authority only in concert with North Western. The simple fact is that the *1976 Decision* neither contained nor implied any such condition. In the absence

of such a condition, the ICC's order of October 22, 1982 can only be sustained as the exercise of an expansive implied power either (1) to alter the terms of carrier authority *after* a carrier has exercised the authority in good faith or (2) to compel a carrier to sell a partial interest in an operating rail line to another carrier at a prescribed price and on prescribed terms. The decisions of this and other Courts indicate that the ICC possesses neither power.

This case is particularly appropriate for Supreme Court review because the court of appeals decision upholding the Commission's authority is so clearly based on a fundamental misconception of the Commission's action. As recounted above, the *1976 Decision* was entirely permissive; it authorized, but did not require, joint ownership and operation.[6] The Commission's goals—environmental protection and safeguarding the financial well-being of North Western—were both met completely so long as only one rail line was built.[7] The Commission's explicit

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[6] It is well established that the ICC cannot compel an unwilling party to begin exercising rail carrier authority. *See* ICC v. Oregon-Washington R.R. & Nav. Co., 288 U.S. 14, 37 (1933); Industrial Comm'n v. New Jersey & N.Y.R.R., 324 I.C.C. 272, 273-74 (1965). Obviously, therefore, the Commission could not have intended its *1976 Decision* to mandate that both parties actually engage in the service authorized.

[7] The Commission's revisionist assertion that the need for "competition" dictates the presence of two carriers cannot be given credence. As stated earlier, the *1976 Decision* did *not* posit a competitive need as the basis for the issuance of joint permissive authority and the evidence of record does not address competitive issues. Moreover, in Union Pac. Corp., 366 I.C.C. 459 (1982), *petition for review filed sub nom.* Southern Pacific Transportation Co. v. ICC, No. 82-2253 (D.C. Cir. Oct. 20, 1982) [hereinafter cited as *Pacific Rail Merger Case*], the ICC clearly held that transportation competition *could not* arise in the circumstances here involved. The ICC's analysis of competition in that case is wholly irreconcilable with its belated and disingenuous advancement of a competition rationale here.

reservation of power to review North Western's financing plans is inconsistent with the premise that the Commission necessarily contemplated dual operations. Neither the Commission nor the court of appeals cited anything in the *1976 Decision* to the contrary.

It was thus simply wrong for the court below to state in its opinion on rehearing, without citation, that "BN and CNW could not by themselves change this joint authority into sole authority for one or the other through contract, or the failure to perform under a contract." App. at 7a. Had North Western been unable to obtain Commission approval of its financing, or had it chosen to invest its limited funds in other projects, the Commission had no power to force North Western to participate in the Powder River Basin project. BN would obviously have been free to go forward in such circumstances; the public interest in rail service to the southern Powder River Basin could not have been contingent upon North Western's financial stability. The lower court's basic premise—that prescription was required to effectuate the *1976 Decision*—is thus fundamentally in error.

Had the ICC conditioned BN's original acceptance of the operating certificate on BN's agreement to abide by any future Commission prescription orders, BN would have had a fair opportunity to consider whether exercise of the authority was worth the price. If BN had exercised its authority on this basis, it would today have no argument against the ICC's prescription power. The only condition implicit in the certificate, however, was that BN could not prevent North Western from operating on the joint line by refusing to negotiate in good faith about the terms of operation. *See, e.g., Chicago, Milwaukee, St. Paul & Pacific Railroad*, 342 I.C.C. 578, 593 (1973). For violation of this condition, the ICC had express statutory power to seek fines, injunctions, or other penalties. *See* 49 U.S.C. §§ 11701, 11702, 11703, 11901 (Supp. V 1981). Had the Commission chosen to follow this course, it would

have been required to afford BN a full hearing, *see* 49 U.S.C. § 11701(a) (Supp. V 1981), or to proceed in a federal district court, where the complete panoply of procedural safegaurds would have been available. *E.g.*, 49 U.S.C. § 11702 (Supp. V 1981).[8]

In short, this is not a case in which implied agency power is necessary to preserve or effectuate an express statutory power. Contrary to the court of appeals' opinion, the Commission's power to enforce conditions on grants of operating authority pursuant to 49 U.S.C. § 10901 is not at issue in this case at all, for the simple reason that the Commission never imposed the asserted condition in its *1976 Decision*. Nor is the Commission's authority to approve carrier-made operating agreements involved here, since the Commission did not have before it an agreement to which both carriers had acceded. It is well settled that the power to review agreements reached by carriers does not carry with it the power to prescribe them. *St. Joe Paper Co. v. Atlantic Coast Line Railroad*, 347 U.S. 298, 305-06 (1954).

In these circumstances, the ICC's decision must be seen as either (1) the retroactive imposition of a condition on BN's exercise of its construction and operating authority or (2) the exercise of a virtually limitless power to compel the sale of rail carrier property merely to satisfy current Commission policy goals. In either case, the result is plainly inconsistent with this Court's past decisions.

As to the first ground, the conditions on which a regulated company exercises authority granted to it by an administrative agency are binding on both the company and the agency. Agencies have no inherent authority to alter

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[8] Moreover, the focus of such a hearing would have been the good faith of BN's asking terms. BN believes it is manifest these terms would have been found to be a commercially reasonable, good faith offer. Indeed, this is the likely outcome on remand if the Commission's existing order is vacated.

those conditions after the fact. *See, e.g., Norfolk & Western Railway v. ICC*, 619 F.2d 1033, 1040-41 (4th Cir. 1980). As this Court has observed, "supervising agencies desiring to change existing certificates must follow the procedures 'specifically authorized' by Congress and cannot rely on their own notions of implied powers in the enabling act." *Civil Aeronautics Board v. Delta Air Lines*, 367 U.S. 316, 334 (1961) (*citing United States v. Seatrain Lines*, 329 U.S. 424 (1947)). The ICC has no express statutory authority to modify certificates issued under 49 U.S.C. § 10901, and it retained no authority to do so in the *1976 Decision*. Thus, any attempt by the ICC to rewrite its prior decision after the fact must be rejected.

The sole remaining ground of the Commission's and the court of appeals' position is the assertion that the ICC has the implied power to impose a buy-in price and the terms of an operating agreement because the Commission *now* believes that joint operation is a desirable goal that can be most expeditiously obtained by the exercise of direct prescription power.

This position is directly in conflict with the decisions of this Court and other courts on the implication of administrative authority. The cases relied upon by the court of appeals are illustrative. In *United States v. Chesapeake & Ohio Railway*, 426 U.S. 500 (1976), the ICC exercised its power to impose express conditions on the granting of a rate increase without suspension. As the Court noted, the carriers in *Chessie* were "not required to submit a tariff imposing such a condition . . . . They had the option to continue to insist on an unconditional increase . . . ." *Id.* at 515. Thus, *Chessie* was not a case where the ICC asserted an implied power to impose a condition retroactively, without fair notice to the carrier affected.

Even more pointed is *Thompson v. Texas Mexican Railway*, 328 U.S. 134 (1946). There the Commission exer-

cised an implied prescription power in order to prevent an unlawful abandonment of service by one of two carriers involved in a trackage rights agreement that had expired by its own terms. *Thompson* indicates that new powers should be implied for agencies only where they are *essential* to preserve the agency's statutory jurisdiction. The same principle is embodied in *American Trucking Association v. United States*, 344 U.S. 298 (1953). As the Fifth Circuit recently observed, the rules under review in *ATA* were upheld only because they were "necessary to preserve the express statutory mandates of the Act." *Central Forwarding, Inc. v. ICC*, 698 F.2d 1266, 1276 (5th Cir. 1983).

Because the decision here goes well beyond the bounds of these guiding precedents, sanctioning an implied power that is both unnecessary and open-ended, it should be overturned. Permitting administrative agencies to compel the sale of regulated property on a prescribed basis, without statutory authority, would have pernicious consequences. As in this case, agency-created procedures may well lead to unfair results, depriving a regulated carrier of its property without adequate compensation. Moreover, the governing policy of the Interstate Commerce Act, which encourages voluntary transactions between carriers, *see St. Joe Paper Co. v. Atlantic Coast Line Railroad*, 347 U.S. 298, 305-06 (1954), would be thwarted by wholesale allowance of such an implied power. Finally, such a power would render express provisions of the Act, such as the Commission's power to impose conditions on initial grants of authority, *see* 49 U.S.C. § 10901 (Supp. V 1981), redundant and unnecessary. *Cf. Hirschey v. FERC*, 701 F.2d 215, 218 (D.C. Cir. 1983).[9]

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[9] Such an implied power would also render superfluous the many explicit provisions of the Interstate Commerce Act, as amended, that grant the ICC authority, in carefully limited circumstances, to prescribe an agreement where the carriers involved are unable to reach one. *See, e.g.*, 49 U.S.C. §§ 11123, 11103, 10901(d) (Supp. V 1981). Congress plainly knows how to grant the kind of power

The court below has thus strayed far from the guiding principles this Court has established for implying non-statutory agency powers. The broad implications of this decision will not be lost on those who practice before the Interstate Commerce Commission, despite the court of appeals' failure to publish a full opinion explaining its decision in this significant case. This Court should grant the writ of certiorari to correct the court of appeals' sharp departure from settled principles and to prevent this unwarranted extension of bureaucratic authority over private rail carriers.

II. The Decision Below Misapplied the "Arbitrary and Capricious" Standard of Agency Review by Sanctioning an ICC Decision Which, Without Reasonable Explanation, Deprived Petitioner of Adequate Compensation for Its Property

Under the Administrative Procedure Act, a reviewing court must "hold unlawful and set aside agency action, findings, and conclusions found to be arbitrary, capricious, [or] an abuse of discretion." 5 U.S.C. § 706(2) (1976). In reviewing an agency decision under the arbitrary or capricious standard, the court "must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 416 (1971). As this Court stated in *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*, 103 S. Ct. 2856 (1983), decided only last Term, a court applying this standard must do more than ensure that the challenged action meets the "minimum rationality" test applied to statutes under the due process clause. *Id.* at 2866 n.9.

Here, the court of appeals appears to have done far less. In its initial judgment, the court stated only that its

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asserted by the ICC here, but chose not to give the ICC broad license to exercise such power.

"review of the Commission's prescribed terms is so limited (citation omitted) [that] we cannot say that the Commission's order should be vacated." App. at 2a. In its June 21, 1983 opinion on rehearing, the panel was equally terse, stating that the price prescribed by the ICC "fully compensated BN for the cost of construction less depreciation and the risks of its investment during the interim when CNW was in default." App. at 6a. A careful analysis by the court of appeals would have shown, however, that the Commission's prescribed price not only fell far short of fully compensating BN for its property, but also was devoid of rational explanation. Moreover, even a casual examination of the Commission's justification for its action—an assertion that the North Western's presence is dictated by competitive need—would have revealed that this rationale was adopted without the development of an adequate record or substantial evidence and further that this rationale is flatly contradictory to the Commission's analysis of transportation competition between the same carriers in a decision issued within two days of the *October 1982 Decision*. *See Pacific Rail Merger Case*, 366 I.C.C. at 535-42; *see also* note 7 *supra*.

A. The Commission's Buy-In Price Methodology Undercompensated BN for the Risk Involved

At the time of the Commission's *1976 Decision*, BN and North Western had agreed to share equally in the costs of constructing the Powder River Basin line. If North Western had made its capital contributions as originally agreed, it, like BN, would have borne a share of the substantial risks the venture entailed, and would have paid competitive, market rates for the capital invested. Instead, North Western chose to sit on the sidelines while BN built the line and pioneered unit train coal service in the Powder River Basin. North Western then demanded to re-enter the project only when financial success was in sight.

The Commission consistently recognized that it would be inequitable under these circumstances to require BN to transfer an undivided one-half interest in the line on the same terms that had been available to North Western prior to its defaults. As the Commission stated in its *1981 Decision*, for example, "CNW's financial obligation to BN includes the payment of interest on CNW's share of the project costs, plus any damages incurred by BN as a result of CNW's delay past the agreed-upon date in tendering its share of those costs to BN." 363 I.C.C. at 920.

Despite prolonged, good-faith negotiations by the parties, the issue of the appropriate payment to be made by North Western had not been resolved by the time of the *October 1982 Decision*. The Commission thus took upon itself the task of calculating a buy-in price. The central element in this process was determining how to adjust the historical cost of building the line to reflect the present value of the line, in light of the risks endured by BN during construction.[10] BN proposed a project cost

[10] Another key element, the depreciation adjustment, was perhaps the most glaring example of the Commission's inability to justify its approach to formulating a prescribed price. The Commission deducted from the "buy-in" price an amount of $5.1 million attributed to "depreciation". *October 1982 Decision* at 9, App. at 25a. This deduction was not only $1 million *more* than North Western had requested, but was also devoid of meaningful explanation. The Commission mentioned "wear and tear" on the line as a possible justification, but failed to discuss the provision in the operating agreement—also prescribed by the Commission—that requires BN to replace worn-out portions of the track during the first five years of joint operation. The Commission's $5.1 million "depreciation" deduction thus results in obvious double-counting. Moreover, the alternative rationale advanced on appeal—that the $5.1 million represents a "return of capital" that BN supposedly has received from its customers—was *expressly* rejected in the October 22 decision. "CNW . . . contends that BN's compensation should be reduced because it has already received a return on capital from its ratepayers", the Commission stated. "We must reject this argument . . . ." *October 1982 Decision* at 7, App. at 20a.

of capital approach that would measure the specific cost of the risks North Western avoided due to its defaults. The Commission, however, chose to apply a much lower 14 percent "corporate cost of capital" rate, representing the weighted average cost of capital to BN as a whole. "This standard," the Commission concluded, "compensates BN for its risk of expending funds which were required when CNW did not tender its share of the construction costs as they were incurred." *October 1982 Decision* at 8, App. at 23a.

As BN demonstrated in its submission to the Commission, this conclusion is simply wrong. BN's overall cost of capital reflects the economic prospects and risk factors associated with *all* of its operations. The ability of BN to raise capital in the financial markets at desirable rates is a valuable asset of the company, built up over many years and properly accruing to the benefit of BN's stockholders.[11] Under the Commission's approach, this asset would be turned to the direct benefit of North Western, in effect, giving it a subsidy at BN's expense.

B. The Commission Failed to Explain Its Cost of Capital Assumptions in a Rational Manner

The Commission attempted to avoid the implications of BN's project cost of capital argument by making a key assumption, namely, that BN's risks on the Powder River Basin project were exactly the same as its overall corporate risks. The Commission's primary assertion was

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[11] BN's creditworthiness is just as much a corporate asset as tax benefits, which the Commission properly recognized should not be used to offset North Western's liability. *See October 1982 Decision* at 9-10, App. at 25a. As the Commission observed in that context: "[W]e do not regard CNW's argument that the BN will be able to defer payment of the tax as having any bearing on the issue because any investment tax [credit] carry-forward is the property of BN's shareholders and should not inure to the benefit of the CNW." *Id.* at 10, App. at 25a. The Commission gave no explanation for its inconsistent treatment of the tax issue and the cost of capital issue.

that the risks BN faced in the Powder River Basin—"uncertain coal market, potential slurry competition, nuclear energy competition, and regulatory uncertainty"—were "identical" to the risks BN faced on all its coal-related investments. *October 1982 Decision* at 8, App. at 23a. The Commission paid too little regard, however, to the most important and specific risks relating to the Powder River Basin project.

First, unlike BN's other coal-related rail maintenance and upgrading efforts, the Powder River Basin project involved construction of an entirely new rail line. It could not begin to generate substantial revenues until the entire line was completed and unit trains began running south from the Powder River Basin mines. *See October 1982 Decision* at 7, App. at 20a.

Second, this project was planned and developed to meet new or projected market demand for the low-sulfur coal found in the Powder River Basin. At the time the project plan was formulated, the mines that would produce the coal were only in the developmental stage, and many of the power plants which would burn it were still on the drawing board. In essence, the entire project was contingent on future events whose occurrence was highly uncertain. The Commission's unsupported assumption that the additional elements of risk peculiar to the Powder River Basin project were "the identical risks BN faced on most of its investments at the time," *October 1982 Decision* at 8, App at 23a, was thus completely arbitrary and contrary to any reasonable judgment about the project's status.

The Commission's other principal argument in favor of its equal risk assumption was that BN's investment in the Powder River Basin project remained relatively low until 1976, by which time the project's risks had diminished substantially. *October 1982 Decision* at 9, App. at 24a.

North Western, however, balked at entering this supposedly "risk-free" enterprise throughout the period from 1976 through 1979. In fact, in November, 1975, only a few weeks before the Commission estimates that all the special risks of this project had disappeared, North Western took a much different view of the risk of the venture. In a letter to the Commission's Deputy Director of Finance, Louis T. Duerinck, then General Solicitor for North Western, stated:

> Over the past year we have witnessed numerous events—such as Congressional and Presidential friction over surface mining legislation, the issuance by a federal court of an injunction restraining the Department of the Interior from issuing any right of way permits for transportation of coal from the Powder River Basin, massive lobbying by coal slurry pipelines to obtain special privileges encouraging the construction of such lines from points in the Powder River Basin to destinations throughout the United States, and the temporary abatement of mining development by at least two companies in the Powder River Basin area. These factors have, of course, served to set back by several years the development of the basin.[12]

Mr. Duerinck went on to say that there was no way North Western could predict when construction might begin or when "the ground rules will finally become known for the surface mining of coal in this region." As a result, he said, "there is no way that anticipated earnings can be projected until such time as more is known about timing and extrinsic events than is presently known."

The Commission, in short, failed to provide any reasoned basis for assuming that BN incurred risks on the Powder River Basin project identical to those embodied in

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[12] This letter was part of the record below, and was reprinted in the Joint Appendix in the court of appeals at pp. 294-96.

its overall corporate cost of capital. These project-specific risks in fact were shown to be much larger than BN's average corporate risk. BN's independent financial advisers, Morgan, Stanley & Co., Inc., estimated that it would have required a premium to equity investors of 8 percent above BN's 17 percent weighted average cost of equity during this period to attract financing to the project. *See October 1982 Decision* at 7, App. at 21a. The Commission, however, made no attempt to determine the appropriate *project* cost of capital. Because of this serious flaw in its methodology, the Commission's decision was arbitrary and capricious.[13]

The court of appeals, far from subjecting the Commission's decision to careful scrutiny, referred to its "review of the Commission's prescribed terms" as "so limited . . . we cannot say that the Commission's order should be vacated." App. at 2a. This constricted approach to judicial review is unacceptable. The statutory directive that agency action be tested under the "arbitrary and capricious" standard should not be undermined by an unduly narrow view of the court's function. Here, had the court of appeals properly applied the Administrative Procedure Act, it undoubtedly would have found the agency's prescription order invalid. Accordingly, even if the Commission were found to have implied prescription authority, this case should be remanded to the lower court for further consideration under a proper standard of review.

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[13] In addition, the Commission erred in prescribing an agreement that requires BN, over its objections, to bear all the labor protective costs occasioned by North Western's belated entry into the project. *October 1982 Decision* at 11, App. at 27a-28a. This inequitable action causes BN, the innocent party in this transaction, to bear expenses that ought properly to be the responsibility of North Western, whose defaults were the source of these prospective losses. *See, e.g.*, National Safe Deposit, Sav. & Trust Co. v. Hibbs, 229 U.S. 391, 394 (1913).

C. The Commission's Prescription Order Was Based on a Competition Rationale Which Was Not Supported by Substantial Evidence and Which the Agency Itself Had Rejected in a Decision Issued Only Two Days Before

As described above, the rationale for the Commission's issuance of the 1976 certificate for the construction of a single Powder River Basin line was to minimize the financial and environmental impacts of building parallel lines. At no time in those early proceedings or in its *1976 Decision* did the Commission posit competition as an issue to be addressed or as the basis for issuance of the joint permissive authority. Not surprisingly, the evidence developed did not address a perceived need for competition but rather was oriented to financial, operating, service and environmental issues. *See 1976 Decision*, 348 I.C.C. at 390-99, App. at 59a-71a. It was only after the fact, and with absolutely no effort to adduce evidence on whether two carriers were desirable in the Powder River Basin for competitive reasons,[14] that the Commission embraced competitive need as the ultimate justification for authority to prescribe terms of a forced partnership between BN and North Western. *See October 1982 Decision* at 4-5, App. at 16a-17a.

Underscoring the arbitrariness of the Commission's competition theory here is its analysis of transportation competition in the *Pacific Rail Merger Case*, 366 I.C.C. 459 (1982), a case decided a mere 48 hours before the *October 1982 Decision* here under review. In the *Pacific Rail Merger Case*, BN adopted the Commission's assumption that competition for the movement of Powder River

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[14] To the contrary, in the parallel *Pacific Rail Merger Case*, the Commission repeatedly *rebuffed* efforts by BN to develop a record bearing on competition issues and denied it meaningful discovery designed to obtain evidence on the extent to which competition was needed or would in fact take place. *E.g.*, BN's Request for Access to Certain Information, Union Pacific Corp., Finance Docket No. 30,000 (unpublished) (decision served March 9, 1981).

Basin coal was desirable, and showed how the Union Pacific-Missouri Pacific merger would, if approved, destroy the very competition the Commission was seeking to create in this case. BN analyzed the utilities served exclusively by Missouri Pacific, which overlap with utility plants the Commission belatedly asserted in the *1981 Decision* would enjoy the benefits of competition between BN and North Western. BN demonstrated how, under the Commission's theory and in the absence of a Union Pacific-Missouri Pacific merger, Missouri Pacific would be a neutral connection for coal originated by North Western or BN.[15] However, BN also showed how, once Missouri Pacific was controlled by Union Pacific, it would favor its new parent over BN and deny BN the independent access to utilities that BN needed to compete. In this fashion, the very competition which the Commission professes to embrace would be destroyed. *See Lamoille Valley Railroad v. ICC*, 711 F.2d 295 (D.C. Cir. 1983); *Transkentucky Transportation Railroad v. Louisville & Nashville Railroad*, ——F. Supp. ——, 1983-2 Trade Cas. (CCH) ¶ 65,476 (E.D. Ken. June 28, 1983). Astonishingly, the Commission rejected BN's analysis in the *Pacific Rail Merger Case* and concluded that competition between origin carriers such as BN and North Western could *not* take place unless each also *directly* served the utility plant. In light of the Commission's contemporaneous advancement of "competition" as the *raison d'etre* for its *October 1982 Decision*, this holding is completely in-

[15] In the so-called Connector Line case (the *1981 Decision*), the Commission assumed that utilities served by more than one carrier and utilities served by a single carrier unaffiliated with BN, North Western or Union Pacific would be "competitive" to BN and North Western. In contrast, utility plants served exclusively by BN, North Western or Union Pacific were assumed by the Commission not to represent "competitive" traffic to the alternative originating carriers. This follows because an originating carrier not having independent access to a destination, either directly or by interlining with a disinterested third party, would have to rely on the willingness of its competition to compete with itself—an unlikely prospect.

explicable, particularly since *only one* of the dozens of utility plants for which the Commission had data is directly served by BN and North Western.

It is abundantly clear that these two decisions cannot be reconciled. At a minimum, even if the court were to conclude that the Commission had statutory authority to act as it did, this case should be remanded to the Commission with instructions to develop an adequate record on the question of competition in light of the lack of existing evidence in this case and the agency's flatly contradictory reasoning in the *Pacific Rail Merger Case*. The *October 1982 Decision* cannot stand on the quicksilver foundation offered by the agency.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment of the Court of Appeals for the District of Columbia Circuit.

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